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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 547

NEW COLONIAL ICE COMPANY, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 34–36) is reported in 24 B.T.A. 886. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 43–47) is reported in 66 F. (2d) 480.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 24, 1933 (R. 47–48). The petition for a writ of certiorari was filed October 24,

1933, and the writ was granted December 4, 1933 (R. 49). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Where a newly organized corporation with capital structure substantially the same as an existing corporation takes over, in exchange for a portion of its capital stock, all the assets and liabilities of the old corporation, and such capital stock is distributed by the old corporation to its stockholders share for share, should the new corporation be treated as the same taxpayer as the old for the purpose of applying the net loss provisions of Section 204 of the Revenue Act of 1921?

STATUTE INVOLVED

The statute involved is set forth in the Appendix, *infra*, pp. 22–23.

STATEMENT

The findings of fact made by the Board of Tax Appeals (R. 27–34), in accordance with the stipulation of the parties (R. 11–21), may be summarized as follows:

Prior to 1922, Colonial Ice Corporation, a New York corporation with authorized capital of $750,000 divided into 6,500 shares of preferred stock of $100 par value and 20,000 shares of common stock of $5 par value, purchased some buildings in New York City and, to convert the same into an ice plant,

entered into extensive contracts for alterations and improvements and for installation of refrigerating machinery (R. 27–28). By August, 1921, the plant was ready for operation at about 40 percent of the entire capacity contemplated, but the company then owed its creditors approximately $285,000 and was not able to pay the same or to secure the additional equipment necessary to operate at a profit (R. 28). There was then formed a Creditors' Committee, as well as a Stockholders' Committee, and upon investigation it was discovered that a large number of shares of stock in the company had been issued without consideration and without any record having been kept showing the parties to whom such stock had been issued (R. 28). The company obtained the surrender of such of the improperly issued stock as it was able to discover and cancelled the same. There then remained 3,385 shares of preferred and 3,385 shares of common stock outstanding which had been legally issued and recorded (R. 28–29).

In August, 1921, the stockholders elected new officers and directors, chosen by the creditors, and in April, 1922, the principal creditor, acting for all creditors, entered into an agreement with the company providing for the completion of the plant and for extension of the time for payment of the indebtedness (R. 29). The company agreed to organize a new corporation, to which it would transfer all its assets in consideration of the assumption of its

indebtedness and the issuance to it of stock in the new corporation (R. 29–30). The creditors agreed to complete the plant and extend the time for payment for five years, the control of the corporation to be vested in the principal creditor under a voting trust agreement until such date as the indebtedness should be paid or the principal creditor should feel justified in surrendering control (R. 30–31). The agreement was not to become binding on the principal creditor until paid in subscriptions for the stock had been received in the amount of $100,000, unless such condition were waived (R. 30).

Pursuant to the agreement New Colonial Ice Company, Incorporated, the petitioner, was organized under the laws of New York with capital of $700,000, divided into 6,000 shares of preferred stock, par value $100 a share, and 20,000 shares of common stock, par value $5 a share, and all the assets and liabilities of the old company were transferred to and assumed by the new company (R. 32). There being 3,385 shares of common and a like number of shares of preferred stock of the old company outstanding at the time of the reorganization, the same number of shares of both common and preferred stock of the new company was issued (R. 32). The new preferred stock was issued to the old company and by it redelivered to the new company with instructions to transfer the same to nominees of the old company (R. 32). The new common stock was issued to three individ-

uals as voting trustees, pursuant to the agreement of April 1922 (R. 32). The trustees issued voting trustees' certificates for the 3,385 shares of new common stock to the old company, which endorsed and redelivered the certificates to the trustees with instructions to transfer the same to the nominees of the old company (R. 32–33). Thereafter the stockholders of the old company, with the exception of the holders of 247 shares of each class of stock, surrendered their old stock and received in lieu thereof, share for share, new preferred stock and voting trustees' certificates for new common stock, and the old stock was thereupon cancelled (R. 33). At the end of 1922 the owners of 247 shares of preferred and common stock of the old company had not exchanged them for new preferred stock and voting trustees' certificates, an equal number of each being held by the new company and the trustees available for such owners of old stock (R. 33). Some time after 1922 the owners of this old stock did exchange the same for a like amount of new preferred stock and voting trustees' certificates (R. 33).

The voting trust created under the agreement of April, 1922, was terminated on April 9, 1927, and the common stock of the new company was then exchanged for the voting trustees' certificates held by the stockholders (R. 33). Upon termination of the voting trust the creditors relinquished control and management (R. 33). The old company

continued in existence throughout 1922 and 1923, but transacted no business and had no assets (R. 33).

The old company sustained statutory net losses of $36,093.19 for the calendar year 1921 and $10,338.90 for the period January 1 to April 13, 1922 (R. 34). The net income of the new company was $48,763.43 for the period April 14, 1922, to December 31, 1922, and $56,242.55 for the calendar year 1923 (R. 34).

For the years 1922 (R. 22A) and 1923 (R. 24A) the petitioner and the old corporation filed consolidated returns. In the 1922 consolidated return they reported a net income of $34,051.93 and claimed a deduction for net loss of $40,676.52 alleged to have been sustained by the old corporation in 1921,[1] thus reporting a net loss of $6,624.59 (R. 22A), which they sought to carry forward and use as a deduction from the new corporation's net income in 1923 (R. 24A).

The Commissioner of Internal Revenue disallowed the deduction for the loss sustained by the old corporation in 1921 (R. 21), but appears to have allowed the new corporation the benefit of the loss sustained by the old corporation for the period January 1 to April 13, 1922[2] (R. 10). The petitioner appealed from the Commissioner's deter-

[1] The actual net loss of the old company for that year was $36,093.19 (R. 34).

[2] It is agreed that for that period the old corporation sustained a loss of $10,338.90 (R. 34).

mination to the Board of Tax Appeals (R. 2–8), contending that the Commissioner erred in refusing to allow it the benefit of the net loss sustained by the old corporation in 1921 (R. 3). In his answer the Commissioner asserted an additional deficiency for the period April 14 to December 31, 1922, on the ground that the petitioner was not entitled to deduct the loss sustained by the old corporation during the period January 1 to April 13, 1922 (R. 10).

The Board of Tax Appeals held that the two corporations were not entitled to file a consolidated return and that the two corporations were separate taxpayers. Accordingly, it refused to allow the petitioner the benefit of the net losses sustained by the old corporation (R. 34–36). The decision of the Board was affirmed by the Circuit Court of Appeals (R. 43–47).

SUMMARY OF ARGUMENT

A taxpayer is entitled only to those deductions expressly authorized by statute, and such deductions are personal to the taxpayer. Ordinarily, the authorized deduction for losses may be taken only in the year in which the losses are sustained. Section 204 of the statute introduced into the revenue laws an exception to the general principle that taxable income must be computed on the basis of annual accounting periods, by permitting the deduction of a net loss sustained in one year from the net income of the two succeeding years. This

privilege, however, is granted only to the taxpayer who sustained the loss and no other taxpayer may take advantage of it.

The petitioner is a separate corporation and distinct entity from the Colonial Ice Corporation, the company which suffered the net losses in question, even though it was organized to take over the business of that corporation, and its stock was distributed to that company's stockholders share for share. Under the statute each corporation was a potential taxpayer. This difference between the corporate entities will not be disregarded in respect of tax matters unless the circumstances are so unusual as to require that the two entities be treated as one. We submit that no decision of this Court furnishes a precedent for the deduction sought here, while decisions of the lower Federal courts and the Board of Tax Appeals, with a few possible exceptions, support the decision below.

We contend that there is no sufficient reason here for treating the two corporations as one continuing entity. There were in fact differences between them, though such differences may have been relatively unimportant. As the Board of Tax Appeals observed (R. 35) "one of the very apparent purposes of the formation of the new corporation was to create a corporation which was separate and distinct from the old corporation." No injustice will result from a strict application

of the provisions of the statute, unless it be that the petitioner's tax will be increased. That fact, we submit, is insufficient.

ARGUMENT

The petitioner asserts the right to deduct from its net income during the period April 14 to December 31, 1922, and the calendar year 1923, the net losses sustained by the Colonial Ice Corporation in 1921 and from January 1 to April 13, 1922. In the court below the petitioner advanced two arguments in support of its position: first, that it was affiliated with the Colonial Ice Corporation during the taxable years in question and was therefore entitled to avail itself of the net losses suffered by that corporation in prior years; and second, that without regard to affiliation the two corporations were in reality one continuing entity and should be treated as a single taxpayer in applying the net loss provisions of the revenue laws. While the petitioner's brief fails to specify the errors intended to be urged, as required by Rule 27, it is apparent that the first contention has been abandoned [3] and that the sole issue now before the Court is whether in the particular circumstances the fact that the petitioner and its predecessor were separate corpo-

[3] Both the Board of Tax Appeals and the court below held that the two corporations were not affiliated. Moreover, affiliation alone would not justify allowance of the deduction. *Woolford Realty Co.* v. *Rose*, 286 U.S. 319; *Planters Cotton Oil Co.* v. *Hopkins*, 286 U.S. 332.

rate entities may be disregarded for the purpose of affording the relief sought.

In computing taxable income only such deductions may be taken as are specifically authorized by the applicable statute. *Brown* v. *Helvering,* decided January 15, 1934, No. 187, October Term, 1933; *Burnet* v. *Thompson Oil & Gas Co.,* 283 U.S. 301, 304. Ordinarily, losses may be deducted only in the year in which they are sustained (*Woolford Realty Co.* v. *Rose,* 286 U.S. 319), and the right of deduction is available only to the taxpayer who suffered the loss. *Busch* v. *Commissioner,* 50 F. (2d) 800, 802 (C.C.A. 5th). See *Anderson* v. *Wilson,* 289 U.S. 20.

Section 204 of the Revenue Act of 1921 (*infra,* p. 22) introduced into the revenue laws a limited exception to the requirement that taxes be computed on the gains and losses of annual accounting periods by permitting taxpayers to carry over the net losses of one year into the two succeeding years. It will be observed, however, that the privilege granted is in terms that of deducting such losses "from the net income of the taxpayer" in the succeeding years, and that the statute does not sanction the application of those losses to reduce the income of any taxpayer other than the one by whom they were sustained. "The statutory net loss deduction has been definitely decided to be a deduction purely personal to the individual taxpayer sustaining it." *Planters Cotton Oil Co.*

v. *Hopkins*, 53 F. (2d) 825, 826 (C.C.A. 5th), affirmed, 286 U.S. 332.

Manifestly the petitioner is not the taxpayer which suffered the losses now sought to be deducted. It was created on April 13, 1922, whereas the losses occurred prior to that date at a time when the petitioner was not in existence. When the petitioner was organized, it became an individual legal entity separate and distinct from the Colonial Ice Corporation, its predecessor. Each corporation was in law a person, having its own existence independent of the other. And under the Revenue Act each corporation was a potential taxpayer.[4]

The petitioner contends, however, that because it was incorporated in the same State as the Colonial Ice Corporation, with the same classes of stock and the same stockholders, for the purpose of carrying on the same business, the technical difference between the two corporations may be disregarded and the petitioner may be treated as the same taxpayer as its predecessor within the meaning of Section 204. Numerous authorities are cited as supporting this proposition, but the majority of them, we submit, are not in point.

While in tax matters, as well as in other types of cases, the courts will sometimes treat two corporations as one, or a corporation as identical with

[4] Section 2 of the Revenue Act of 1921 (*infra*, p. 22) defines the term "taxpayer" as including any person, trust, or estate subject to the tax imposed, and the word "person" includes partnerships and corporations as well as individuals.

its sole stockholder, only exceptional circumstances will be held to justify such disregard of the corporate entity. *Burnet* v. *Commonwealth Improvement Co.*, 287 U.S. 415, 419–420. Generally speaking, two corporations, no matter how intimately they may be related, will be treated as separate taxpayers for all purposes, and this Court has on several occasions given warning that decisions departing from this general principle may not be regarded as precedents in cases in which the circumstances are not substantially the same. *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330, 338; *Lynch* v. *Hornby*, 247 U.S. 339, 346; *Burnet* v. *Commonwealth Improvement Co.*, *supra*, p. 420.

Southern Pacific Co. v. *Lowe*, 247 U.S. 330, *supra*, and *Gulf Oil Corp.* v. *Lewellyn*, 248 U.S. 71, which the petitioner cites, "cannot be regarded as laying down any general rule authorizing disregard of corporate entity in respect of taxation." *Burnet* v. *Commonwealth Improvement Co.*, *supra*, p. 420. Those cases involved the taxability of dividends paid by corporations to other corporations owning all of their capital stock, and the decisions turned wholly on the peculiar facts under consideration (see *Southern Pacific Co.* v. *Lowe*, *supra*, p. 338), which were, we submit, so dissimilar to those involved here as to deprive the cases of any value as precedents in the instant case.

Weiss v. *Stearn*, 265 U.S. 242, and *Marr* v. *United States*, 268 U.S. 536, involved the question

whether taxable income, or gain severed from capital, was realized by a stockholder exchanging stock held in one corporation for a like amount of stock in a new company created in pursuance of a plan of reorganization. The Court directed its attention in each case to the specific question whether the stockholder received by virtue of the exchange anything substantially different from what he originally had. It is apparent that the considerations upon which the decisions turned are far removed from those involved here.

The decision below is in accord with the great majority of the decisions in respect of the right of one corporation to take advantage of net losses sustained by another to whose assets and business it has succeeded. *Athol Manufacturing Co.* v. *Commissioner,* 54 F. (2d) 230 (C.C.A. 1st); *Swedish Iron & Steel Corp.* v. *Edwards,* 1 F. Supp. 335 (S.D.N.Y.); *Clark Dredging Co.* v. *Commissioner,* 23 B.T.A. 503, affirmed on other grounds, 63 F. (2d) 527 (C.C.A. 5th); *Elliott-Granite Linen Co.* v. *Commissioner,* 26 B.T.A. 936; *Hartford Empire Co.* v. *Commissioner,* 26 B.T.A. 134; *Plumber's Supply Co.* v. *Commissioner,* 20 B.T.A. 459; *West Point Marion Coal Co.* v. *Commissioner,* 19 B.T.A. 945. See also *Manufacturers' Trust Co.* v. *Commissioner,* 28 B.T.A. 1259; *Overbrook National Bank of Philadelphia* v. *Commissioner,* 23 B.T.A. 1390; *Standard Silica Co.* v. *Commissioner,* 22 B.T.A. 97; *Maytag Co.* v. *Commissioner,* 17 B.T.A.

182; *Donner* v. *Commissioner,* 16 B.T.A. 758; *Appeal of White House Milk Co.,* 2 B.T.A. 860.

Industrial Cotton Mills v. *Commissioner,* 61 F. (2d) 291 (C.C.A. 4th), cited by the petitioner, is, we submit, distinguishable on its facts although the reasoning of the court tends to support the petitioner's contentions. There it was held that a corporation might deduct a net loss sustained by another corporation which had merged with it. The court stated, however, that the merger alone was not sufficient to justify disregard of the corporate entity. The controlling fact upon which the decision turned was that the taxpayer, prior to the merger, had been nothing but a holding company owning all the stock of the merging corporation, and had derived all its income from the latter.

There are likewise grounds for distinguishing *Pioneer Pole & Shaft Co.* v. *Commissioner,* 55 F. (2d) 861 (C.C.A. 6th); *H. H. Miller Industries Co.* v. *Commissioner,* 61 F. (2d) 412 (C.C.A. 6th); and *Phillips* v. *Lyman H. Howe Films Co.,* 33 F. (2d) 891 (C.C.A. 3d). Nevertheless, as we stated in our memorandum answering the petition for certiorari, we hesitate to contend that there is less justification for treating the corporations as one continuing entity in the instant case than there was in those cases. We believe that the *Pioneer Pole & Shaft Co.* and *H. H. Miller Industries Co.* cases were erroneously decided. In the *Lyman H. Howe Films Co.* case, we submit, the conclusion reached by the court was correct in view of the fact that the

taxpayer was in the position of a transferee, regardless of whether it could properly be treated as a mere continuation of its predecessors.

Western Maryland Railway Co. v. *Commissioner,* 33 F. (2d) 695 (C.C.A. 4th) and *Commissioner* v. *Sansome,* 60 F. (2d) 931 (C.C.A. 2d), are, we submit, plainly distinguishable. In the former, as the court itself observed, the taxpayer fell heir to all the obligations of the corporation with which it was merged and was, therefore, wholly regardless of any question of the identity of the two corporations, entitled to amortize the discount on the bonds of such corporation for which it had assumed liability. In the *Sansome* case the Circuit Court of Appeals for the Second Circuit held that earnings and profits of a corporation taken over by a new company upon reorganization retained the character of earnings and profits for purposes of distribution to stockholders under Section 201 of the Revenue Act of 1921, and did not become capital assets which upon distribution could be used to reduce or amortize the cost of the stockholders' investment. In order to reach this result the court construed Section 201 in conjunction with Section 202, which provides for cases of corporate reorganization resulting in neither gain nor loss to the participating shareholders, and expressly disavowed any intention of relying on cases dealing with the continuity of corporate existence in general, which it characterized (p. 933) as "decisions

, certiorari denied, 287 U.S. 667,

made in analogous, though not parallel, situations." Here, as the same court pointed out (R. 46), we are concerned solely with the application of Section 204, and there is no such intimate relation between that section and Section 202 as to warrant their being construed together.

"Analogous, though not parallel," cases lend support to the decision below. Thus, it has been held that a corporation organized to take over the business of a partnership, all of the stock being owned by the partners, may not compute on the basis of "discovery value" the depletion of an oil well which was "discovered" by the partners (*Darby-Lynde Co.* v. *Commissioner*, 51 F. (2d) 32 (C.C.A. 10th)); that in the absence of an exempting statute the exchange of assets of one company for all the capital stock of another constitutes a taxable transaction (*Insurance & Title Guarantee Co.* v. *Commissioner*, 36 F. (2d) 842 (C.C.A. 2d), certiorari denied, 281 U.S. 748; see *Burnet* v. *Riggs National Bank*, 57 F. (2d) 980, 983 (C.C.A. 4th)); that an assessment against one company does not *ipso facto* establish a lien upon the assets of its successor (*Hill* v. *Firemen's Insurance Co.*, 25 F. (2d) 1007 (W.D. Ark.)); and that prior to the enactment of Section 280 of the Revenue Act of 1926 a corporation could not prosecute an appeal to the Board of Tax Appeals in respect of a deficiency asserted against its predecessor (*Carnation Milk Products Co.* v. *Commissioner*, 15 B.T.A. 556, 559). See also *Dalton* v.

Bowers, 287 U.S. 404; *Burnet* v. *Clark,* 287 U.S. 410; *Marr* v. *United States,* 268 U.S. 536; *McDonald* v. *Commissioner,* 52 F. (2d) 920 (C.C.A. 4th); *Nixon* v. *Lucas,* 42 F. (2d) 833 (C.C.A. 2d); *Commissioner* v. *Van Camp Packing Co.,* 67 F. (2d) 596 (C.C.A. 7th).

It would be futile to attempt to harmonize the above decisions with those to which the petitioner has referred. Each case of this type turns not only upon its peculiar facts but to a large extent upon the purpose for which continuity of corporate life is sought to be recognized. We cannot agree with the petitioner (Br., p. 14) that the courts may not "adopt one formula in determining who is the taxpayer when the question of a taxable gain is involved, and a different formula when the question of deductible loss is to be considered." It seems obvious that wholly different considerations may be involved in the two situations. For instance, in determining whether there is a taxable gain the courts must bear in mind the constitutional limitations upon the power of Congress in respect of income taxation (see *Marr* v. *United States,* 268 U.S. 536, *supra,* p. 539), whereas the allowance of a loss is solely a matter of statutory interpretation. *Burnet* v. *Thompson Oil & Gas Co.,* 283 U.S. 301, 304, *supra.*

We submit that no reason is here apparent for treating the petitioner as anything other than it actually is, namely, a separate legal entity and a

distinct taxpayer. The fact that the petitioner was formed for the purpose of taking over, and did take over, the assets and business of the Colonial Ice Corporation does not make the two corporations identical. Indeed, there were differences between them which, though perhaps of relatively little importance, evidenced the change that had taken place. Thus, the petitioner was capitalized with $50,000 less preferred stock than its predecessor, and the stockholders were temporarily deprived of a valuable right through the creation of a voting trust. True, these changes might have been effected without the creation of a new corporation, but that makes no difference. See *Volker* v. *Crooks,* 53 F. (2d) 886, 887 (W.D. Mo.). The identity of the stockholders was "but a temporary condition, subject to change at any moment at the option of any individual," and the very fact of the transfer of the assets from the old company to the new "evidenced the actual separateness of the two companies." *United States* v. *Phellis,* 257 U.S. 156, 174. As the Board of Tax Appeals aptly observed (R. 35):

> The mere fact that the new corporation was incorporated under the laws of the same state as the old corporation does not necessarily mean that each corporation has the same rights, franchises, powers, privileges and immunities. In fact, one of the very apparent purposes of the formation of the

> new corporation was to create a corporation which was separate and distinct from the old corporation. * * *

If the petitioner was the same taxpayer as the Colonial Ice Corporation, only one return should have been filed for the years in question, irrespective of the provisions relating to affiliation. *Swedish Iron & Steel Corp.* v. *Edwards,* 1 F.Supp. 335, *supra.*[5] See *Sweets Co. of America* v. *Commissioner,* 40 F. (2d) 436 (C.C.A. 2d). Cf. *American Paper Exports* v. *Bowers,* 54 F. (2d) 508, 509 (C.C.A. 2d).

It has been held that the fact of separate identity will not be ignored except to prevent fraud or manifest injustice. See *Turner & Farber-Love Co.* v. *Helvering* (App.D.C.), unofficially reported in Prentice-Hall Federal Tax Service (1934), par. 517. There is, we submit, no injustice in treating the petitioner for tax purposes as just what it has held itself out to be in all other respects—a new and independent entity. In *Falk Corporation* v. *Commissioner,* 60 F. (2d) 204 (C.C.A. 7th) it was held that a newly organized company might not take a deduction for a state income tax asserted against

[5] In that case the court said (p. 338): "Corporation No. 1 filed a tax return for the period from May 1 to October 10, 1918, and the 'new corporation' * * * filed its return for the period from October 10 to December 31, 1918, thereby clearly indicating its own understanding that it was a different taxpayer from corporation No. 1."

its predecessor and paid by it pursuant to an agreement with such predecessor, whose assets it had acquired in exchange for capital stock. After pointing out that the stockholders in both companies were substantially the same, and the interests identical, and that the new corporation had been formed for the express purpose of taking over and carrying on the business, the court said (p. 207):

> We think it is fair to assume that the benefits anticipated by the creation of that separate entity have been realized, and no facts or special circumstances have been presented from which the court can fairly say that a manifest injustice will be done by continuing to regard the two corporations as separate entities, unless it be the fact that petitioner's income tax will thereby be increased. This fact we deem insufficient.

We submit that the petitioner is unable to point to any provision of the statute authorizing it to deduct losses sustained in a prior year by a different legal entity. Since the allowance of deductions is a matter of legislative grace and the burden is upon the taxpayer to show that the statute sanctions the deduction claimed (*Woolford Realty Co.* v. *Rose,* 286 U.S. 319, 326, *supra*), it would seem to be clear that the petitioner is not entitled to the relief which it seeks.

CONCLUSION

The decision below should be affirmed.

Respectfully submitted.

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FEBRUARY 1934.

APPENDIX

The Revenue Act of 1921, c. 136, 42 Stat. 227, 231, provides in part:

SEC. 2. That when used in this Act—

(1) The term "person" includes partnerships and corporations, as well as individuals;

* * * * *

(9) The term "taxpayer" includes any person, trust or estate subject to a tax imposed by this Act;

(U.S.C., Title 26, Sec. 1262.)

* * * * *

SEC. 204. (a) That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such trade or business); and when so resulting means the excess of the deductions allowed by section 214 or 234, as the case may be, over the sum of the following: (1) the gross income of the taxpayer for the taxable year, (2) the amount by which the interest received free from taxation under this title exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not permitted to be deducted by paragraph (2) of subdivision (a) of section

214 or by paragraph (2) of subdivision (a) of section 234, (3) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gains or profits not derived from such trade or business, (4) amounts received as dividends and allowed as a deduction under paragraph (6) of subdivision (a) of section 234, and (5) so much of the depletion deduction allowed with respect to any mine, oil or gas well as is based upon discovery value in lieu of cost.

(b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

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